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Ireka - defensive property and construction play

IREKA Corp (RM1.13) is one of the country's oldest construction companies, tracing its roots back to 1967. Today, the property and construction company has a very different and unique business model - one that is asset-light, with sustainable income streams and relatively defensive in nature despite operating in two cyclical industries.

Its shares are also trading at attractive valuations - at just 5.4 times FY March 2009 earnings (which are sustainable and excludes large exceptional gains in FY08), and 0.5 times book. Dividends are attractive with a sustainable net yield of over 6%. We recommend a buy.

Ireka's RNAV

	Value (RM mil)
(1) 19.6% stake in ASPL @ US$0.92 per share (RM3.20/ USD)	138.0
(2) Construction arm: net profit of RM15.8m x 7 times P/E	110.6
(3) IDM's management fees stream @11% discount rate	64.6
(4) Net debt at Dec 2007	(47.7)
Total RNAV	265.5
No. of shares (million)	113.92
RNAV per share (RM)	2.33
Fair value, assuming 25% discount to RNAV (RM)	1.75

Over the past year, Ireka has quietly undertaken a major restructuring exercise that has unlocked substantial value and created an asset-light balance sheet with recurring income streams.

In January 2007, Ireka sold the prestigious but loss-making Westin Kuala Lumpur for RM455 million cash, setting a new benchmark of over RM1 million per room and clearing the bulk of debts. This was followed in April 2007 with the listing of Aseana Properties Ltd (ASPL) on the London Stock Exchange and the concurrent disposal of four other property assets to the company.

In total, Ireka has unlocked RM673.8 million worth of assets, realised RM203 million in one-off profits and pared all its debts - all for a company with a market capitalisation of just RM129 million. It is now in very good financial shape.

Ireka's earnings forecast

Year-end March (RM mil)	2006	2007	2008E	2009E	2010E
Revenue	230.6	186.5	296.5	366.0	370.7
Operating profit	10.1	(34.7)	3.9	34.8	39.7
Depreciation	(2.2)	(1.9)	(2.0)	(2.1)	(2.2)
Interest income / (expense)	(9.1)	(14.2)	(2.0)	(0.7)	(0.2)
Exceptional items & others	(0.1)	14.6	175.8	-	-
Pretax profit	(1.3)	(36.2)	175.7	32.0	37.3
Tax	(1.9)	1.6	(3.0)	(8.3)	(9.7)
Discontinued operations	(1.0)	1.3	-	-	-
Net profit	(4.2)	(33.3)	172.7	23.7	27.6

With its new corporate structure in place, Ireka has a steady stream of sustainable earnings, balanced with cyclical construction profits. From ASPL, it will earn annual fees from managing its US$250 million (RM795 million) assets, dividends and upside from performance fees. Through ASPL it also has access to a large war chest for future investments in Malaysia and Vietnam.

The construction arm's order-book will grow from RM360 million to around RM860 million by May, with the inclusion of the Seni Mont' Kiara project. This is likely to grow further given the pipeline of new projects in Malaysia and Vietnam undertaken by ASPL. It is turning more aggressive as the strengthened balance sheet allows it to bid for bigger and better projects.

Earnings outlook

In FY March 2007, Ireka posted a net loss of RM33.3 million, largely from some external construction projects that were hit by rising costs. These losses continued in 1HFY08, but have since ceased as all external projects have been fully completed. The construction arm now caters for in-house projects, namely those developed by ASPL. We expect Ireka to post a net profit of RM172.7 million in FY March 2008, or a sizable RM1.52 per share, boosted by exceptional gains from the disposal of properties to ASPL. After being distorted by exceptional gains though, FY09 will provide a more realistic picture of future and sustainable earnings.

We expect construction revenue of RM350 million, with pretax margins of 6%. Together with IDM's management fees, we estimate Ireka's total FY09 pretax profit at RM32 million, net profit at RM23.7 million and EPS at 20.8 sen. This translates into a very low P/E of just 5.4 times and 0.5 times its projected book value of RM2.36.

Undervalued, with high yields

At the current market price of US$0.88, the 19.6% stake in ASPL is worth RM138 million - more than Ireka's market capitalisation of RM129 million.

This means no value is accorded to its other assets, namely the construction arm and stream of management fees - both of which will drive Ireka's earnings going forward. In fact, investors are effectively buying into ASPL at a 7% discount through Ireka, and the other assets come free.

We estimate Ireka's RNAV at RM2.33 per share - more than twice the current share price. If we accord a 25% discount to RNAV, its shares should be worth RM1.75 over the longer-term.

Ireka is not only undervalued, but is a fairly defensive stock with relatively good and sustainable dividends. We expect dividend payout rate of 31%-34% in FY09-10 - on a sustainable basis - which translates into net dividends of 7 sen and 7.5 sen per share, respectively. This will provide investors with high net dividend yields of 6.2% and 6.6% respectively.